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THE DILEMMA OF REGULATING SMALL BUSINESS: THE NEED FOR A NEW POLICY FRAMEWORK

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I. INTRODUCTION

THE frequent concerns raised by small businesses that regulations have a disproportionate impact on their operations are often regarded by federal regulators as bothersome “political” or “public relations” problems. These regulators see small businesses as a fringe group that appears politically well organized on the general issues that affect its constituency. However, regulators perceive specific regulations as having only a minimal negative impact on small businesses, which is outweighed by the concerns raised by the broader constituent group at which such regulations are directed.

The perception of many regulators that small-business concerns need not be taken very seriously is reinforced by a number of factors. First, the regulatory promulgation process itself is complex and regulators tend to deal with large institutions or organizations. Comments on proposed regulations, letters, congressional pressure and direct contacts are typically initiated by larger institutions such as major corporations, trade organizations and unions. Indeed, it is this type of organization that is able to participate in the complex regulatory promulgation process and understand how to influence the outcome of a specific rule. Discussions and frequent contact between such organizations and regulators tend to confirm the “appropriateness” and “reasonableness” of proposed rules, particularly once the concerns of these larger entities have been met.

There are, of course, a number of organizations specifically representing small business which often do participate in the rulemaking process. However, the concerns such organizations raise are typically of a generic nature, namely to exempt small

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business completely or to make some provision for "tiering" regulatory requirements.¹ Even such tiering recommendations are often cast in general terms, such as calls for "less stringent" requirements for small businesses, rather than specific changes in proposed regulatory language that could be used by the regulators to better tailor a standard to the needs of this group.²

A second factor which contributes to the discounting of small-business concerns by regulators is the regulators' common perception of the scope of the regulatory problem which they are addressing. In so many cases, the regulatory problem is seen as one emanating from large corporations. For example, large industrial concerns are seen as the major cause of pollution, illness, injuries and corruption. Thus, in the eyes of regulators, it is toward these organizations that standards are most appropriately directed.

Finally, there is the difficult question of just what is a "small business." It has been noted: "There is no law or regulation that defines precisely what a small business is, which may be a reflection of the problem small businesses face as a group—everyone supports them in principle, but not always in practice."³ Indeed, a definition of a small business has been specified by the Small Business Administration (SBA) through a rulemaking process. This definition, however, takes up nearly fifty pages in the Code of Federal Regulations.⁴ It is so expansive that regulators quip

1. See Cohen, *Small Business Is Getting a Big Reception in Washington*, 24 NAT'L J. 896, 896 (1977). Advocates of "tiering" argue that small business is different from big business and thus that there should be a two-tier system of laws and regulations. *Id.* The small business community makes two arguments in support of a two-tier system: (1) The administrative costs of regulation are a burden which corporate giants can easily meet, but is one which could destroy smaller companies; and (2) small businesses are at a competitive disadvantage under an even-handed application of the laws and regulations. *Id.* For a discussion of empirical studies demonstrating the disproportionate burden placed on small businesses, see *infra* notes 38-42 and 44-46 and accompanying text.

2. But see Cohen, *supra* note 1, at 898. One area where tiering requests have been specific is tax laws. See *id.* Small businesses have repeatedly requested different (lower) tax rates, different income reporting bases, simplified depreciation rules and capital gains roll-over provisions. See *id.*

3. *Id.* at 896.

4. See 13 C.F.R. § 121 (1988). The crux of the definition is that no "exact quantitative procedure" exists to establish the standards that a business must meet to qualify as a small business. *Id.* § 121.1(b). Size can be measured in terms of employment, assets or receipts. See THE SMALL BUSINESS ADMIN., THE STATE OF SMALL BUSINESS: A REPORT OF THE PRESIDENT 19-21 (1988) [hereinafter THE STATE OF SMALL BUSINESS]. Specific size limits are defined for over 700 industries in the SBA regulations with varying standards in each industry. 13 C.F.R. § 121.2. Furthermore, different definitional standards may apply de-

that by using the SBA definition, every corporation except General Motors is a small business. Even the SBA is uncomfortable with its official definition in the context of tailoring regulations.⁵ Specifically, the SBA has urged the use of within-industry criteria so that defining a business as small depends upon the particular industry in which it operates.⁶

Together the above factors tend to diminish the importance of small business in the eyes of regulators. Small businesses are an undefined group, seemingly not related in any significant way to the regulatory problem at hand. Their concerns are expressed in general terms using the same message repeatedly. In short, regulators see small business's concerns as not worthy of serious consideration.

II. THE REGULATORY DILEMMA AND ITS RESOLUTION

A. *How Important Are Small Businesses to Regulatory Compliance?*

Notwithstanding the fact that larger industrial corporations typically do present greater regulatory problems, federal regulatory agencies, if they are to be effective, must address the problem of regulating small businesses. The problem can best be framed by the available data on firm size. In the tax year 1987, an estimated 18.1 million *business* tax returns were filed.⁷ Tax returns were filed by 3.7 million corporations, 1.9 million partnerships and 12.6 million sole proprietorships.⁸ Using the most common definition that firms which employ 500 or more workers

pending upon the regulatory purpose. *Id.* § 121.1(d). For example, special rules apply when a business is trying to invoke the special benefits applicable to small businesses which buy or lease government property or which attempt to procure a government contract. *See id.* §§ 121.5-121.6.

5. With the passage of the Regulatory Flexibility Act (RFA), the SBA strongly urged agencies to adopt their own definition of what constitutes a small business for purposes of a particular rule. Such urgings were consistent with the legislative intent in passing the RFA, which was to encourage agencies to "utilize innovative administrative procedures in dealing with . . . small businesses." *See* S. REP. NO. 878, 96th Cong., 2d Sess. 1, *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS 2788, 2788. Specifically, the RFA encourages agencies to tailor regulations to match the size of the small entities which it seeks to regulate by imposing fewer, simpler requirements. *Id.* at 2798. For the text of the RFA, see 5 U.S.C. §§ 601-612 (1982). For a discussion of the RFA, see *infra* notes 30-37 and accompanying text. For the text of the Small Business Act regulations defining what constitutes a small business, see 13 C.F.R. § 121 (1988).

6. *See* 13 C.F.R. § 121.1 (1988).

7. THE STATE OF SMALL BUSINESS, *supra* note 4, at 20-21 (1988).

8. *Id.*

are large businesses,⁹ *all but 7000* of the 18.1 million businesses would be classified as small.¹⁰ In terms of employment, *over fifty percent* of American workers are employed in industries dominated by small businesses.¹¹ This compares to approximately thirty-six percent of employment in industries dominated by large businesses.¹²

The importance of addressing the small-business sector is further demonstrated by examining the target of many federal regulations. The Department of Labor, for example, administers approximately 140 statutes. Regulations derived from these statutes fill hundreds of pages in the Code of Federal Regulations and cover such diverse areas as the required wage rates of alien workers, minimum wage requirements, child labor protections, private pension security, vocational rehabilitation, apprenticeship programs, the collection of data by the Bureau of Labor Statistics, overtime pay and occupational health and safety, to name a few.¹³ A vast number of these regulations are directly applicable to small businesses. If regulations cannot address the needs of this sector of the economy, then it is highly doubtful that widespread compliance with such regulations can be achieved.

A brief glance at other areas of federal regulation show a similarly broad potential impact on small businesses. Environmental regulations, tax regulations, trucking regulations and health-care regulations, among many others, involve very significant numbers of small businesses. In sum, the enormous size of the small-business sector makes it imperative for federal regulators to effectively communicate regulatory intent and compliance guidance if their regulations are to be effective.

9. While more detailed breakdowns are also used, for most statistical purposes, the SBA defines small businesses as those having either fewer than 500 or fewer than 100 employees. *Id.* at 19 & n.12.

10. *Id.* at 20-21.

11. *Id.* at 13 (Table 3). Small-business-dominated industries are defined as those in which 60% or more of the industry's employees work in firms with fewer than 500 employees. *Id.*

12. *Id.* Large-business-dominated industries are defined as those in which 60% or more of the industry's employees work in firms with greater than 500 employees. *Id.* The remainder of industries (those in which small or large-business employment shares fall between 40-60% of industry employment) are deemed indeterminate industries and account for 10.1% of the work force. *Id.*

13. To get a fuller flavor of the broad scope of federal labor laws, most of which are administered by the Department of Labor, see *FEDERAL LABOR LAWS* app. at 529-918 (9th ed. 1988).

B. *The Current Regulatory Setting*

The question is often raised as to why federal regulations do not meet the concerns of small business more effectively. The issue has certainly received considerable attention from the legislative and executive branches. Indeed, a number of major initiatives have been launched.¹⁴ Some answers to this question are suggested by a review of the current rulemaking climate and evaluation of the administrative and legal framework in place today.

In many ways, the current climate can be traced to the substantial increase in regulatory activity in the 1960's and 1970's. The sharp increase in regulatory activity from such newly-created agencies as the Environmental Protection Agency (EPA), the Occupational Safety and Health Administration (OSHA), the Pension and Welfare Benefit Administration (PWBA) and the Consumer Product Safety Commission (CPSC) resulted in a dramatic increase in the total regulatory burden imposed on businesses. In addition, individuals in favor of social regulation saw the regulatory process as a means through which the reach of these regulations could be extended beyond the original scope of the regulatory statutes.¹⁵ Individuals opposed to social regulation saw many of these regulations as unnecessary, not cost-effective, overly complex and inflationary.

These latter concerns were heeded by the Ford, Carter and Reagan Administrations, each of which initiated a series of regulatory reform efforts.¹⁶ Two basic threads ran through these reg-

14. For a discussion of these initiatives, see *infra* notes 16-28 and accompanying text.

15. See, e.g., W. NISKANEN, *BUREAUCRACY AND REPRESENTATIVE GOVERNMENT* (1971) (developing general theory of bureaucratic supply of public services and corresponding demand for bureau's output in environment of representative government and suggesting changes in bureaucracy, sources of supply of public services and political institutions); R. NOLL & B. OWEN, *THE POLITICAL ECONOMY OF DEREGULATION* (1983) (developing theory of regulation as tool for well-organized interests often used for self-protection at expense of poorly-organized interests for whom regulation was originally created to protect).

16. See Yandle, *The Evolution of Regulatory Activities in the 1970s and 1980s* in *ESSAYS IN CONTEMPORARY ECONOMIC PROBLEMS*, 1986: *THE IMPACT OF THE REAGAN PROGRAM* 105-45 (P. Cagen ed. 1986). The Ford Administration set the foundation for future administrations by instituting regulation-review mechanisms which focused on cost-benefit analysis and cost-effectiveness determination and by considering alternative means of regulation. *Id.* at 118-19, 123. The most notable of these mechanisms was a requirement that executive branch agencies file economic impact statements for newly proposed rules. *Id.* Many initiatives from the Ford era were continued and expanded by the Carter Administration. For example, economic impact statement requirements were broadened. *Id.* at 119-20, 123. In addition, the Carter Administration attacked large

ulatory reform initiatives. First, there was the concern that regulations were too burdensome, costly and unnecessary. Second, there was the concern that small businesses bore a disproportionate share of the regulatory burden.¹⁷ The policy responses to both of these concerns contributed significantly to establishing the current regulatory structure—and dilemma. Specifically, the regulatory promulgation process was transformed from a process encouraged and minimally supervised by the executive branch to one which is discouraged and highly supervised. The transformation has created a burdensome, highly litigious struggle for both the proponents and opponents of regulation.

The response to the first concern—that regulations were too burdensome, costly and unnecessary—was first addressed by the Ford Administration's inflation impact statement program, which was later formalized as the economic impact statement requirement.¹⁸ This program required that an economic analysis be prepared and published upon the final promulgation of a regulation.¹⁹ The Carter Administration subsequently increased

businesses through antitrust laws in an attempt to "deconcentrate" industries. *Id.* The Reagan Administration refined and expanded the efforts of the earlier administrations. More stringent and precise guidelines for review of regulations have been developed and are applied under the supervision of the Office of Management and Budget (OMB). *Id.* at 120-24. Additionally, all executive-branch agencies must submit an annual statement to the Director of the OMB containing a coherent description justifying all regulatory programs existing or planned for that year. *Id.*

In effect, all three administrations have created an increasingly hostile environment in which to pass regulations. Regulations are not subject to the influence of parties outside the agency, particularly the OMB, which increases both the difficulty in passing a regulation and the opportunity for organized special interests to influence the process. *Id.*

17. For a discussion of the regulatory burden placed on small businesses and proposals to alleviate it, see *infra* notes 38-51 and accompanying text. For a discussion of empirical studies demonstrating the disproportionate burden placed on small business, see *infra* notes 38-42 and 44-46 and accompanying text.

18. See Exec. Order No. 11,821, 3 C.F.R. 926 (1971-1975), reprinted in 12 U.S.C. § 1904 app. at 766 (Supp. V 1975) (Gerald R. Ford).

19. See Exec. Order No. 11,821. Section 1 of Executive Order No. 11,821 states: "Major proposals . . . for the promulgation of regulations or rules by any executive branch agency must be accompanied by a statement which certifies that the inflationary impact of the proposal has been evaluated." *Id.* at § 1. This order was the first step in forcing agencies to directly address the concerns of the regulated community that regulations were too burdensome, costly and unnecessary. The order mandated that the certification process consider:

- a. cost on consumers, businesses, markets, or Federal, State or local government;
- b. effect on productivity of wage earners, business or government at any level;

these analytical requirements dramatically in Executive Order 12,044 requiring that a regulatory analysis²⁰ be prepared at the time of the notice of proposed rulemaking for certain "significant" regulations found to have "major economic consequences."²¹ These regulations were also subject to review by the Regulatory Analysis Review Group (RARG) which was chaired by the Council of Economic Advisors.²² Both the regulatory analysis and any comments submitted by the RARG became part of the rulemaking record subject to judicial review.²³

c. effect on competition;

d. effect on supplies of important products or services.

Id. at § 3. For the background and an assessment of the Economic Impact Statement, see Miller, *Lessons of the Economic Impact Statement Program*, 1 REGULATION, July/Aug. 1977, at 14-21.

20. A regulatory analysis is a formal document which has to be made available by the agency to the public. See Exec. Order No. 12,044, § 3, 3 C.F.R. 671 (1961-1981) (James Carter). In the analysis, the agency must explain the problem the proposed regulation is addressing, justify that the proposed regulation is superior to other methods of addressing the problem and include an analysis of the economic consequences of each method considered. Exec. Order No. 12,044 at § 3(b).

21. *Id.* at § 3. Executive Order No. 12,044 provided criteria for determining which regulations were significant. In identifying such regulations, an agency would consider, inter alia: "(1) the type and number of individuals, businesses, organizations, State and local governments affected; (2) the compliance and reporting requirements likely to be involved; (3) direct and indirect effects of the regulation including the effect on competition; and (4) the relationship of the regulations to those of other programs and agencies." *Id.* at § 2(e)(1)-(4). However, an agency's conclusion that a regulation was significant did not automatically mandate that a regulatory analysis be done for the regulation. See *id.* at § 3. Agency heads were then directed to establish and apply criteria mandating regulatory analyses for all regulations which would (a) have an annual effect of \$100 million or more on the economy or (b) result in a major increase in costs or prices for individual industries, levels of government or geographical regions. *Id.* at § 3(a)(1). In addition, if the regulation did not meet these criteria, the agency head still had authority to order that a regulatory analysis be completed on any proposed regulation. *Id.* at § 3(a)(2).

22. RARG was essentially responsible for overseeing the quality of regulatory analyses and usually submitted a formal public comment following publication of the proposed regulation in the Federal Register as part of the notice of proposed rulemaking process. See Eads, *Harnessing Regulation: The Evolving Role of White House Oversight*, 5 REGULATION, May-June 1981, at 19-26.

23. *Id.* The extent of such judicial review can be seen in the recent decision of the United States Court of Appeals for the District of Columbia Circuit in *Building & Construction Trades Department, AFL-CIO v. Brock* in which the court addressed OSHA's asbestos standard. See 838 F.2d 1258 (D.C. Cir. 1988). The opinion went into considerable detail on the measurements of asbestos fibers per cubic centimeter, significance of risk at various levels of exposure, the synergistic effect of smoking, short-term exposure levels, technological feasibility and random uncontrollable fluctuations. *Id.* This would seem to contradict the intent of the Administrative Procedure Act to give regulatory agencies wide leeway in regulatory decisionmaking provided that they have given appropriate notice

The Reagan Administration, which had run on a platform of regulatory reform, extended the analytical requirements for rulemaking with its issuance of Executive Orders 12,291²⁴ and 12,498.²⁵ Review of regulations was now housed in the Executive Office of the President, specifically, the Office of Management and Budget (OMB). The Director of the OMB was given substantial power including the authority to return to agencies regulations that failed to satisfy the review criteria set forth in the Executive Orders.²⁶

The net result of these Executive Order requirements was to sharply increase the analytical underpinnings of regulations. While information provided by such analysis is laudable, these requirements have greatly increased the time and resources needed to promulgate regulations. Further, these requirements have opened major new avenues for judicial review. The detailed analysis provided in a regulatory impact analysis has become grist for both the opponents and proponents of regulations such that the "informal rulemaking" process, established by the Administrative Procedure Act,²⁷ has become encrusted with executive and judi-

and comment. For the text of the Administrative Procedure Act, see 5 U.S.C. §§ 500-576 (1982 & Supp. IV 1986).

24. Exec. Order No. 12,291, 3 C.F.R. 127 (1982), *reprinted in* 5 U.S.C. § 601 app. at 431-34 (1982) (Ronald Reagan). This order expanded the definition of a significant rule to include any rule with major adverse effects on competition, employment, investment, productivity, innovation or American competition with foreign markets. *See* Exec. Order No. 12,291 § 1(b)(3). Two other major effects of this order were the requirement that a cost-benefit test be applied and the installation of the Office of Management and Budget (OMB) as overseer of the regulatory process. *See id.* §§ 3(d), 6. The OMB was given substantially more power than RARG, its predecessor under the Carter Administration. *See* Eads, *supra* note 22, at 19-21. For a discussion of the criteria used to define significant regulations prior to Executive Order 12, 291, see *supra* note 21 and accompanying text.

25. Exec. Order No. 12,498, 3 C.F.R. 323 (1985), *reprinted in* 5 U.S.C. § 601 app. at 107-08 (Supp. IV 1986) (Ronald Reagan). This order sought to further coordinate the regulatory process by increasing "the accountability of agency heads . . . provid[ing] for Presidential oversight of the regulatory process . . . [and] minimiz[ing] duplication and conflict of regulations." *Id.* The main provision of this order required each agency to file an annual statement of "its regulatory policies, goals, and objectives." *Id.* § 1(a).

26. In evaluating regulations, the Director of OMB was to consider whether the proposed regulations were consistent with the administration's policies and the regulations of other agencies. *See id.*; *see also* OFFICE OF MANAGEMENT AND BUDGET, INTERIM REGULATORY IMPACT ANALYSIS GUIDANCE, *reprinted in* FEDERAL ADMINISTRATIVE PROCEDURE SOURCEBOOK 22-35 (Office of the Chairman 1985) (setting forth five criteria required to be addressed by regulatory impact analysis).

27. 5 U.S.C. §§ 551-559 & 701-706 (1982 & Supp. IV 1986).

cial branch review requirements. The promulgation of a regulation, in short, has become a very major undertaking.

The impact of these analytic requirements, while generally improving the quality of regulations, particularly for those organized interests able to pursue remedies under this costly process, has created substantial difficulties for small businesses. The mere complexity of the rulemaking process itself now excludes many from effectively participating in the development of rules. The impact of a regulation is discussed in highly technical, legal and economic terms such as the discounted streams of future costs and benefits, sensitivity analysis and monetization of benefits. Total costs and benefits are arrayed in terms of a societal framework rather than in terms understandable to the specific subgroups affected by a regulation. Much of the language in a regulation and its preamble are written with judicial review in mind rather than for the purpose of conveying the simple, clear meaning of the regulation. The cry for regulatory reform has elicited a bureaucratic response—more paper, more “analysis” and more review in each branch of the government.

To make matters more difficult, compliance with any particular regulation, once promulgated, is an increasingly complex task. For example, simply reading the recently published OSHA formaldehyde standard provides relatively little guidance as to how a firm should comply.²⁸ Understanding this standard, which has a considerable impact on a broad spectrum of small businesses requires a careful reading of the preamble which in itself is a 500-page document. Such vital preamble language, however, is not published in the Code of Federal Regulations. Thus, those wishing to understand the intent of the specific regulatory language in the standard must locate the preamble language in the Federal Register of the day on which the final regulation was originally published.

Finally, the preamble language, in conjunction with the rule, still does not provide complete guidance as to how a firm should comply with a regulation. Agency “guidance” and “interpretations” in addition to rulings from Administrative Law Judges and, from time to time, the federal courts, embellish the original interpretations of a regulation so that a full understanding is often not possible without considerable research.

28. See Occupational Exposure to Formaldehyde, 52 Fed. Reg. 46,168 (1987) (to be codified at 29 C.F.R. § 1910.1048).

C. *The Regulatory Flexibility Act*

Paralleling the concerns raised by the dramatic increase in regulatory activity in the 1960's and 1970's over costly and unnecessary regulations was the concern about the differential impact of regulations on small business. Reports prepared by the Senate Select Committee on Small Business in the late 1970's contained numerous examples of the problems faced by small businesses due to the disproportionate impact of regulations on such entities.²⁹ In 1977, the Regulatory Flexibility Act³⁰ (RFA) was introduced and required agencies to identify and discuss regulatory alternatives which would meet the stated objectives of applicable statutes and minimize unnecessary burdens on "small entities." The Committee on the Judiciary's Report on the RFA stated the need for flexible regulations:

When the government chooses to act through regulation by defining acceptable conduct through administrative rules, it faces squarely a basic tension in the law: the inescapable conflict between uniformity and diversity, between rule and discretion, and between the "rough justice" of broad categories and justice tailored to the equities of individual situations.

. . . .

Today, it is quite clear that government agencies nearly always choose the former of each of those alternatives. Regulations tend to be uniform in design, permit little discretion in their implementation, and implicitly assume that all those subject to them are basically alike.³¹

Enacted in 1980, the outstanding requirement of the RFA was that agencies perform "regulatory flexibility analyses" as part of the rulemaking process.³² Specifically, such analyses were required for those regulations deemed to have a "significant economic impact on a substantial number of small entities."³³ In

29. S. REP. NO. 878, *supra* note 5, at 2790 (citation omitted).

30. 5 U.S.C. §§ 601-612 (1982).

31. S. REP. NO. 878, *supra* note 5, at 2790.

32. See 5 U.S.C. § 603(a) (1982). The RFA requires an agency to prepare both an initial regulatory flexibility analysis which it publishes along with the proposed rule and a final regulatory flexibility analysis which accompanies the final rule and a statement of basis and purpose. *Id.*

33. *Id.* § 605(b). The RFA failed to define what is meant by "significant economic impact." This failure was intentional as the Senate believed a clear

those cases where there was no significant economic impact, the agency head was required to certify that finding in writing to the newly created Chief Counsel for Advocacy within the Small Business Administration. The Chief Counsel was to monitor and report to the President and Congress federal agency compliance with the RFA.³⁴

Introduced with considerable fanfare, the RFA has been disappointing in that it has not significantly changed federal agency behavior in regulating small businesses. While the Office for Advocacy has been able to intercede in a number of regulations to improve their acceptability to small businesses, limited staff and the absence of any direct enforcement mechanism requiring agencies to perform adequate analyses has frustrated the goal of the RFA. In addition, section 611(b) of the RFA provides that agency compliance not be subject to judicial review, but also that regulatory flexibility analyses shall be considered as part of the overall record for the purpose of such review.³⁵

The practice under the RFA, for the vast number of regulations, has been for agencies to certify to the Chief Counsel for Advocacy that the regulations do not have a substantial impact on small entities. Courts have reached conclusions consistent with that expressed in *Thompson v. Clark*³⁶ in which the United States Court of Appeals for the District of Columbia Circuit held that while a regulatory flexibility analysis is part of the overall rulemaking record, agency certification that no such analysis is required is not subject to judicial review.³⁷

Even in those cases where a flexibility analysis was per-

definition would be counterproductive. See Verkuil, *A Critical Guide to the Regulatory Flexibility Act*, 1982 DUKE L.J. 213, 242-43 (citing 126 CONG. REC. S10,943 (daily ed. Aug. 6, 1980)).

34. 5 U.S.C. § 609(3) (1982). For a comprehensive discussion of the RFA, see Verkuil, *supra* note 33.

35. See 5 U.S.C. § 611(b) (1982); THE SMALL BUSINESS ADMIN., ANNUAL REPORT OF THE CHIEF COUNSEL FOR ADVOCACY ON IMPLEMENTATION OF THE REGULATORY FLEXIBILITY ACT 10 (Apr. 1987).

36. 741 F.2d 401 (D.C. Cir. 1984).

37. See *id.* at 405; see also *Lehigh Valley Farmers v. Block*, 640 F. Supp. 1497, 1519-20 & n.20 (E.D. Pa. 1986) (citing 126 CONG. REC. 21,460-61 (1980)) (notwithstanding contradictory statements by Senator Culver in legislative history, court agreed with *Thompson* court and concluded that proposed rule will not have significant economic impact on substantial number of small entities and is not subject to judicial review), *aff'd*, 829 F.2d 409 (3d Cir. 1987); *Mast Indus. v. Regan*, 596 F. Supp. 1567, 1573 n.9 (Ct. Int'l Trade 1984) (dicta that "compliance or noncompliance of agencies with the [RFA] and Executive Order 12,291 is specifically precluded from judicial review").

formed, with a limited number of exceptions, few dramatic changes have been adopted in the regulation itself. Typically, such changes have involved reduced paperwork requirements, modest exemptions from certain provisions of a rule, reduced training requirements and scaled user fees. In the final analysis, small businesses must comply with essentially the same provisions in newly promulgated regulations that are required of large companies.

D. *Economic Impact of Regulations on Small Businesses*

At the time of the enactment of the Regulatory Flexibility Act, there was little empirical evidence that small businesses bore a disproportionate share of the regulatory burden. While little direct evidence was available at that time, there were well-known reasons why one should expect such disproportionate burdens a priori. Specifically, larger businesses can spread the administrative costs of complying with regulations over larger sales volumes than smaller businesses can. Also, there are economies of scale in legal costs. Finally, in the case of capital equipment requirements, larger businesses typically can average such costs over a larger quantity of production.

There are now a number of empirical studies such as those by Booz-Allen and Hamilton,³⁸ B. Peter Pashigian,³⁹ Arthur Andersen⁴⁰ and Cole and Sommers⁴¹ which demonstrate such differential impacts. The most recent and most comprehensive study was prepared by Jack Faucett Associates entitled *Economies of Scale in Regulatory Compliance: Evidence of the Differential Impacts of Regulation by Size of Firm*.⁴² This study examined fourteen major regula-

38. BOOZ-ALLEN & HAMILTON, IMPACT OF ENVIRONMENTAL REGULATIONS ON SMALL BUSINESS (1982) (regulations create entry barriers, restrict competition and support monopoly power).

39. Pashigian, *The Effect of Environmental Regulation on Optimal Plant Size and Factor Shares*, 27 J.L. & ECON. 1 (1984). For a summary version of this article, see Pashigian, *How Large and Small Plants Fare Under Environmental Regulation*, 7 REGULATION, Sept.-Oct. 1983, at 19-24 (environmental regulation affects small industrial plants more adversely than large plants, mostly through greater allocation of funds to capital compared to labor).

40. ARTHUR ANDERSEN & CO., ANALYSIS OF REGULATORY COSTS ON ESTABLISHMENT SIZE FOR THE SMALL BUSINESS ADMINISTRATION (1979) (demonstrating differential economic impact of regulations on small businesses).

41. R. COLE & P. SOMMERS, COMPLYING WITH GOVERNMENT REQUIREMENTS: THE COSTS TO SMALL AND LARGER BUSINESSES (1981) (final report to SBA) (demonstrating that disproportionate burden on small businesses varies across industries).

42. JACK FAUCETT ASSOC., ECONOMIES OF SCALE IN REGULATORY COMPLI-

tions which were paired with four-digit Standard Industrial Classification⁴³ (SIC) industry sectors affected by the respective regulations. By analyzing those regulation-industry pairs, the study concluded that the relative burden of regulation is substantially greater for small firms than for large firms.⁴⁴

Using nonparametric scaling factors, the Faucett study found that the total regulatory compliance cost per employee at the mid-size firms was 1.35 times higher than that of the large firms.⁴⁵ The total regulatory compliance costs per employee for small firms was estimated at 2.83 times that of large firms.⁴⁶ In sum, the results of the Faucett study constitute strong evidence of the disproportionate burden placed on small businesses by federal regulations.

However, these studies underestimate the severity of the problem since they attempt to estimate the *actual* differential costs incurred, whereas, most studies examine the differential cost that would be incurred *were there full compliance with a set of regulations*. The problem, for example, can be seen in the Faucett study which used agency regulatory impact analyses for cost data rather than actual cost estimates. There is considerable evidence, however, that many small businesses (and some large businesses) respond to regulations by not fully complying or simply not complying. Whether or not such compliance is forthcoming in the case of any particular regulation is, of course, dependent upon a number of factors. The newness of the regulation, its complexity, the relative costs of compliance and the degree of agency enforcement contribute to the degree of compliance achieved. For example, the federal minimum wage standard⁴⁷ currently has a relatively high degree of compliance as it is generally well understood, widely publicized and relatively unburdensome. By comparison, a new OSHA regulation, such as the hazard communication standard⁴⁸ which has relatively complex provisions, would probably

ANCE: EVIDENCE OF THE DIFFERENTIAL IMPACTS OF REGULATION BY FIRM SIZE (1984) (final report to SBA Office of Advocacy).

43. For an explanation of the SIC coding system, see EXECUTIVE OFFICE OF THE PRESIDENT, STANDARD INDUSTRIAL CLASSIFICATION MANUAL (1987). The SIC codes were established "for purposes of facilitating the collection, tabulation, presentation, and analysis of data . . . and for promoting uniformity and comparability in the presentation of statistical data." *Id.* at 11.

44. JACK FAUCETT ASSOC., *supra* note 42, at i.

45. *Id.* at xv.

46. *Id.*

47. 29 U.S.C. § 206 (1982).

48. 29 C.F.R. § 1910.1200 (1987).

reveal relatively poor compliance, especially since compliance inspections occur very infrequently for the typical firm. It is, of course, in the latter category that a substantial number of the newer social regulatory actions fall.

E. *The Dilemma Facing the Regulators of Small Businesses*

The dilemma of achieving broad compliance in the face of increasingly complex regulatory promulgation requirements poses significant problems for the regulating agency. On the one hand, the regulatory process is already overly complex, costly and time consuming. To tailor regulations carefully to the needs of small business under this process would almost require separate rulemakings. Extraordinary effort would be needed to significantly meet the regulatory concerns of small business. On the other hand, small businesses constitute such a large share of the economy and employment that significant regulatory compliance by this group is necessary if an acceptable level of compliance is to be achieved.

The regulator and regulated communities appear to be locked into a system that is not beneficial to either party. For the regulator seeking to achieve compliance with a regulation, or more fundamentally, to change behavior, the current structure requires extraordinarily lengthy and complex procedures. Compliance with Administrative Procedure Act requirements, regulatory impact analyses, regulatory flexibility analyses, paperwork reduction filings, environmental impact analyses and other administrative requirements are just the initial stages of rulemaking. The lengthy review processes within agencies and subsequently at the Office of Management and Budget are then often followed by legal challenges which extend the promulgation process even further. These requirements are so difficult to meet that in the case of OSHA, the agency has been able to promulgate only nineteen section 6(b) health standards since it was established.⁴⁹ The *average* regulatory impact analysis costs the agency a quarter of a million dollars. For larger standards, these costs have been considerably higher. The regulatory problem for OSHA is placed in perspective when one compares the number of health stan-

49. See *Oversight Hearings on the Occupational Safety and Health Administration Before the Senate Comm. on Labor and Human Resources*, 100th Cong., 2d Sess. (1988) (statement of Michael E. Baroody, Assistant Secretary of Labor for Policy) (available from Department of Labor).

dards actually issued with the estimated one-half million hazardous substances in the workplace.

The regulating community, notwithstanding regulatory analyses and regulatory flexibility analyses, has failed in its goal of achieving simple, flexible and cost-effective regulations. The tools intended to achieve the end—administrative procedures, various analyses, executive branch and judicial reviews—simply have produced an overwhelmingly complex and litigious process. Only the largest of companies with very substantial resources for direct intervention into the process itself generally understand the development and promulgation of a regulation.⁵⁰ This leaves the vast majority of regulated firms unable to participate effectively and to influence such rulemakings.

F. *Toward Resolution of the Dilemma*

Just as it is the regulators' goal to change the behavior of those whom they are regulating, regulators themselves must undergo a change in behavior to achieve effective compliance. The promulgation of a regulation by itself does not achieve such compliance. Compliance is a function of a number of factors including the ease with which one who is willing to comply is able and compelled to comply with a regulation.⁵¹ Since, in practice, enforcement activity is severely constrained by resource factors, most compliance must be achieved essentially through *voluntary* compliance. Rules which are perceived as too complex, overly burdensome and unfair obviously will meet with resistance from the regulated community and be ignored.

The rulemaking process described above simply does not provide the mechanism for meaningful input from the substantial small business sector of the economy. The regulatory flexibility analysis requirement, intended to sensitize the regulating community to the needs of small business, is seen as a burdensome requirement thrust upon the regulators. The notice and comment procedures under the Administrative Procedure Act, for all practical purposes, are not an available avenue for most small businesses to address their concerns. The argument that small businesses are represented effectively in the rulemaking process

50. For an interesting insight into the complexity of the regulatory process and how to operate effectively in this arena, see DeLong, *How to Convince an Agency: A Handbook for Policy Advocates*, 6 REGULATION, Sept.-Oct. 1982, at 27-36.

51. For a most thoughtful statement on compliance, see Dunlop, *The Limits of Legal Compulsion*, 27 LAB. L.J. 67 (1976).

through trade organizations and specific associations has not been demonstrated when it comes to specific regulatory actions. While it is clear that such organizations do represent small businesses' interests to some degree, it remains obvious that there is a long way to go before a substantial number of regulations will be tailored to the needs of this constituency.

The following list of actions suggest the types of changes federal regulators must make if they are to truly alter the structure of their regulations to meet the needs of small entities:

1. Agencies must carefully establish priority systems for promulgating regulations. The volume of federal regulations is overwhelming. With so many requirements, there is little else for the small business to do other than to ignore many regulations.

2. In many cases, rules must be developed with small businesses primarily in mind. This means very careful wording of regulations, preferably with the direct input and assistance of small businesses. Regulators, thus, should seek the advice of small businesses through advisory committees, negotiated rulemaking techniques and other similar channels. Passive acceptance of meeting small business concerns through the notice and comment process is not sufficient.

3. The federal government should provide direct compliance assistance to small businesses in implementing regulations. In the case of OSHA regulations, the federal government, which is required to comply with such standards itself, should be used as a testing ground in which the regulations would be implemented with the guidance and training materials made available to the general public. Adaptation of implementing procedures, handbooks, training films, tool kits and other media should be prepared for use by small businesses and widely distributed at minimal cost.

4. Agencies should issue fewer specification standards in favor of performance-oriented regulations. The frequent complaint that performance-oriented regulations are difficult to comply with should be dealt with by including nonmandatory compliance "guidance." Such information would be especially helpful if there were

separately directed guidance aimed at large, medium and small entities.

5. Agencies should carefully monitor the implementation of regulations and listen to complaints and problems surrounding compliance. Compliance assistance should be revised regularly to address such complaints.

6. Agencies should take advantage of new information-dissemination techniques to help small businesses comply with regulations. For example, with laser disks, tremendous amounts of information can be compactly stored on a single disk. Such disks could carry substantial information about a very large number of regulations including compliance guidance to small businesses. The information could be organized across regulations thus providing the user with a checklist approach specifying the basic federal requirements for general areas such as environmental control, health and safety and benefits. Information that is readily available and formatted in a user-friendly mode would encourage compliance by small businesses.

III. CONCLUSION

It is increasingly clear that small businesses—however defined—represent a substantial sector of the regulated community. Failure to reach this large group and to change its behavior essentially guarantees the failure of a regulatory agency to achieve broad compliance with its regulations. Reforms in the regulatory promulgation process, and specifically those designed to remedy the problems associated with regulating small businesses, have not effectively addressed this problem. Those reforms, and others intended to improve the efficiency and cost-effectiveness of regulations, have substantially added to the burdens and delays in promulgating regulations. Further, they have instituted a process that is not easily accessible to small businesses because of its complexity and the costs of intervention. Evidence is mounting that the costs of new regulations are indeed disproportionately falling on small businesses. This has led to regulatory inequities or simple noncompliance. It is in the interests of both the regulators and the regulated to rethink the current regulatory structure. This can be achieved within the current statutory framework;

however, it does require a fundamental behavioral change in how agencies approach the regulatory promulgation process with respect to small business.